

profile

May 11, 1998

Higher costs damper 1997 earnings for managed care industry

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The managed care industry struggled to meet Wall Street's earnings expectations in 1997. HMOs nationwide generally fell short of anticipated earnings last year, reporting losses or smaller gains than in 1996. Even some of the industry's heaviest hitters—Kaiser Permanente and Oxford Health Plans—reported significant losses. Kaiser lost \$270 million last year, while Oxford reported losses in excess of \$291 million.

Results in Florida—one of the most competitive markets in the country—were no different. At Blue Cross and Blue Shield of Florida (BCBSF) we track ourselves against 12 key competitors in the state, and 11 of those companies reported lower earnings in 1997 than in 1996. Two-thirds of Florida's 38 HMOs reported losses totaling \$67.9 million during the fourth quarter of 1997.

"These results reflect an extremely competitive health care marketplace and increases in medical costs," says

Charlie Richards, vice president of Financial Services. To a large degree, the industrywide spike in medical expenses can be attributed to the movement of the over 65 population HMO-based medicare risk products and continued government cost shifting to the industry as a whole.

BCBSF earnings

For the ninth consecutive year, BCBSF experienced positive consolidated earnings and enrollment gains in 1997. BCBSF reported 1997

net income of \$51 million on revenues of nearly \$3.2 billion. The company also reported an overall enrollment gain of more than 100,000 customers.

"We're pleased with our consolidated financial results and enrollment gains relative to our competitors," says Chris Doerr, senior vice president and chief financial officer. "But, overall, we didn't do as well as we expected, primarily because Health Options, like many HMOs, experienced a loss."

According to news reports, Prudential Health Care Plan Inc. in Florida lost \$56 million in 1997. United HealthCare of Florida posted a small loss, and two HMOs, Ultramedix and Health Care System of Tampa and Sunrise Healthcare Plan, failed.

Our HMO subsidiary posted a 1997 net income loss of \$11.5 million on revenues of \$1.3 billion. Although Health Options earned money during the first three quarters of 1997, earnings declined each quarter. During the fourth quarter, Health Options lost \$24 million, largely because of higher costs and nonrecurring accounting adjustments. Results were filed with the Department of Insurance in March.

Work under way to improve performance

"We have a number of initiatives under way to improve our competitive position," says Richards.

As required under state law, Health Options along with others filed a corrective action plan explaining why expectations were not met and describing the changes and initiatives in place to improve financial results. Our improvement efforts include implementing additional medical cost action, raising prices and simplifying our business, which should lower administrative costs.

In recent years, average HMO rate increases were quite low. Our 1997 rates did not fully cover our medical costs, which increased faster than expected last year primarily because of rising pharmacy and outpatient costs. We're raising 1998 rates for our PPO and HMO business.

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Significant BCBSF 1997 results

- Year-end consolidated revenues increased almost 14.3 percent to nearly \$3.2 billion.
- Overall enrollment increased by more than 100,000 new customers.
- Total assets increased approximately 12.5 percent to \$1.8 billion.
- Investment and related income grew by \$22.6 million to \$93.7 million, with a major contribution from realized gains in a favorable equity market.
- Policyholders' equity grew more than 10 percent to \$836.1 million.
- Standard & Poor's affirmed its A+ ratings of BCBSF, and the A.M. Best Company affirmed its A rating.

Design Group is a catalyst for change

Whether it's seeking feedback on Organization Re-design or uncovering problems bubbling up from inside our company, the senior leadership of Blue Cross and Blue Shield of Florida (BCBSF) often looks to a group of 16 employees for answers.

The Design Group serves as a tool to help in the company's self-improvement efforts. Members act as a sounding board for employee concerns and recommend to management ways of achieving needed improvements. Issues addressed can run the gamut from poor communications to retraining needs to policies that create undue stress. The concept was established at BCBSF as a means of successfully managing change by William Flaherty in the late '70s when he became president.

"There is a human side to be addressed whenever a strategy, policy or reorganization is put into place," says Catherine Kelly, senior vice president, Human Resources. "Design Group serves as a testing ground to assure that our corporate initiatives will succeed." The Human Resources Committee charters Design Group.

The Design Group consists of employees who represent a cross-section of BCBSF, structurally and demographically. They serve voluntarily on the committee for an 18- to 24-month term. Candidates must be nominated by a current Design Group participant and sponsored by a Senior Leadership Team (SLT) member.

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Higher costs

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Competitors are raising their rates as well, also reflecting rising medical costs.

Medical Cost Management (MCM) Initiative

The 1998 medical cost management initiative has a target of reducing medical expenses significantly this year. As part of the initiative, several programs under way to improve the performance of all product lines include:

- **Pharmacy program**—includes the selection of Merck Medco to manage our pharmacy benefit as of Jan. 1, 1998, and to process claims beginning in July; and the establishment of a Medicare & More prescription drug program in South Florida, where coverage is limited to medications prescribed from an approved list.
- **Outpatient program**—includes a coding program designed to help us predict and manage outpatient costs.
- **Audit program**—includes regular audits of provider billing practices in order to ensure that health care services are properly paid.

"These programs saved nearly \$28 million dollars through the end of March," says Barbara Benevento, senior vice president of Health Care Services. "Containing medical costs is a top priority for the company so we will continually develop and implement programs to keep medical-cost increases reasonable."

Business simplification

Business simplification is working to reduce the complexity of our products. One effort involves

standardizing product lines across all geographic business units (GBUs). The variation in the five regions' unique HMO benefits plans have become too cumbersome and expensive to administer in today's environment.

Another effort involves clarifying our contract language so it is consistent across the GBUs and can be translated into "rules" required by the new claims processing system used in Virtual Office.

"These efforts will produce significant administrative savings," says Bill O'Nale, director of Product Management. "But perhaps more importantly, they will improve the value of our customer promise—the experience our customers have with all aspects of their health care—so that we retain customers and attract new customers."

Employees can help

These efforts show our continued commitment to growing our share of the managed care market, improving our financial performance and continuing to position ourselves as a leader in managed care. But we need help from employees throughout the organization.

"Managers across the company need to effectively manage their plans and budgets to help us contain administrative expenses," says Richards. "And all employees can look for opportunities to do our jobs more effectively and at lower cost."

Catalyst for change

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Informal vs. formal

What sets Design Group apart from other corporate committees is that members represent BCBSF's informal organization. Their mission is to raise management's awareness of the concerns of that informal network. A formal organization is the traditional reporting structure of the company—a hierarchy based on authority and accountability. The informal organization is composed of people who interact daily, develop personal attachments, and learn work habits outside the formal expectations of management. Members chosen to serve on the Design Group understand the formal organization and have a strong informal network of relationships. They are usually seen as informal "leaders" within the corporation and, consequently, Design Group serves as a good developmental assignment for career-minded employees. Past members include Mike Cascone, Barbara Benevento, George Cassady, Bruce Davidson and Bob Lufrano, among many others.

Current Design Group Members

Titi Alphonso, *South GBU*
James Barnes, *Public Relations*
Frank Bennett, *Information Technology*
Pat Corbe, *Facilities*
Carol Corn, *Human Resources*
Brenda Francisco, *Medicare*
Woody Gash, *Information Technology*
Tom Gniech, *Information Technology*
Cathy Herren, *Marketing*
David Hotchkiss, *Finance*
Ari Jolly, *Legal Affairs*
Jeanne Lauten, *Central GBU*
Karen Morris, *North GBU*
Sidney Ough, *Florida Combined Life*
Mike Pierce, *HCS*
Karl Smith, *Operations*

The group examines the human side of corporate issues, explains Tom Gniech, senior project consultant and Design Group chairman.

"Our findings help management better understand the impact on employees. We take the temperature of the organization. We talk about issues affecting our areas and identify three or four hot topics that overlap those areas." Additionally, the group reviews and provides feedback on a variety of corporate initiatives and human resources policies before they are implemented.

"Our greatest challenge is resistance to change," says Kelly. "The Design Group is a catalyst for change.

They can make it happen. As informal leaders, they provide the fertile ground for the seeds of ideas that are brought to them."

Ultimately, Design Group's responsibility is to recommend ways to improve how the corporation functions. They attack issue analysis using a four-step corporate improvement model: awareness, analysis, action, actualization.

Following this model, the group:

- identifies needs and opportunities,
- analyzes the problems and priorities,
- sets objectives and conditions that yield a good solution, and
- prioritizes alternative recommendations.

The group does not implement actions; that is left to corporate leadership. But their feedback makes a difference in the way the corporation implements policies, and sometimes their recommendations have a direct impact on employees' lives. Gniech points to the recent change in dress code and a change in the security badge policy.

Current hot topics include Organization Re-design, the effects of 1998 planning and budgeting, and the common office environment, which involves corporate-wide technological capabilities.

"Change is happening more quickly now than it ever has before in this company," says Gniech. "As it does, the need for a group like this is even greater."

How temperature-taking works in an organization

